2/10/86 A7000-1

February 1986

Outlook for the Economy and Real Estate

REALTOR®

Forecasting & Policy
Analysis Division
NATIONAL ASSOCIATION OF REALTORS®
777 14th Street, N.W.
Washington, D.C. 20005

Outlook for the Economy and Real Estate

The growth rate for real (inflation-adjusted) Gross National Product (GNP) in the fourth quarter of 1985 has been revised downward to 2.4 percent, down sharply from the "flash" estimate of 3.2 percent and the 3.0 percent growth rate of the third quarter. The downward revision was due primarily to a larger than previously expected trade deficit. The primary cause of the slower fourth quarter growth rate was an actual decline in consumer spending for durable goods such as automobiles as consumers restrained spending due to high debt burdens. For the entire year, real GNP increased 2.3 percent compared to the 6.6 percent growth rate of 1984.

Despite the slowdown for the entire quarter, in December there were some signs of a renewal of economic growth. Payroll employment rose 320,000 during that month, well above the 180,000 increase of November, and the civilian unemployment rate fell to 6.9 percent. Retail sales rose 1.9 percent for the month while industrial production rose 0.7 percent. These indicators of faster economic growth brought the bond rally to a halt as they were interpreted to preclude further easing of monetary policy by the Federal Reserve Board (FED) at this time.

This modest rebound of the economy is expected to continue through the first quarter of 1986, with real GNP growth rising to 2.6 percent. This expected pickup in growth is due primarily to improved automobile and light truck sales, as manufacturers again provide financing incentives, and inventory rebuilding. By the second quarter of 1986 growth should decline to about 2.0 percent as both consumer spending and inventory investment subside. By the second half of 1986 and well into 1987 real economic growth should remain at or below 2.0 percent with a recession becoming a stronger possibility. Deficit reduction mandated under Gramm-Rudman-Hollings could exacerbate this slowing of economic growth unless the FED stimulates the economy through a further easing of monetary policy.

For all of 1985 inflation, as measured by the Consumer Price Index (CPI), was 3.8 percent compared to 4.0 percent in 1984. Despite some indications that inflation may accelerate, such as the decline in the dollar and higher average wage increases, during 1986 these forces are likely to be offset by declining oil prices. In fact, for all of 1986 inflation should further slow to 3.2 percent. However, inflation is likely to start accelerating in 1987.

Modest inflation, weak economic growth, and hope that advances are finally being made in deficit reduction have reduced long-term interest rates by one and one-half percentage points over the past three months, while short-term rates have remained fairly constant. Declines in long-term rates will likely resume once credit markets and the Federal Reserve gain confidence that the current economic rebound is both modest and short-lived. Further, pressure on the FED from the Administration and Congress add to the likelihood of further easing of monetary policy.

Real Estate Markets

Strong response to falling mortgage interest rates raised existing single-family home sales to 3.53 million units in December from a rate of 3.42 million units in November. For the first time since 1979, the 1985 sales total in the resale market broke the three million unit mark at 3.216 million homes sold. With further modest declines in mortgage rates of one-quarter to one-half percentage points in 1986 home resales should total 3.5 million units in 1986 and 3.4 million units in 1987. The December median resale price increased $200 to return to its October level of $74,800. During 1985 the median resale price rose 3.7 percent. Housing starts surged 17.5 percent in December to an annual rate of 1.84 million units bringing the 1985 year-end total to 1.73 million units. Starts should decrease in 1986 to 1.78 million units and 1.75 million units as economic activity slows in 1987.

TABLE 1

February 1986

U.S. Economic Outlook

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product													
(billions of dollars)	4016.9	4075.1	4137.6	4187.8	4229.2	4277.2	4326.8	4376.5	3774.7	3992.5	4208	4393	4617.6
% Change	5.8	5.9	6.3	5.0	4.0	4.6	4.7	4.1	11.0	5.8	5.4	4.4	5.1
% Change (w/out inflation)	3.0	2.4	2.6	2.1	1.5	2.1	1.7	1.0	6.6	2.3	2.2	1.5	1.1
Consumption	4.6	0.2	2.7	2.2	1.5	1.4	1.8	0.7	4.4	3.2	2.1	1.2	0.6
Durables	24.3	-15.7	5.0	2.2	0.3	0.8	2.6	1.2	12.4	8.2	1.5	0.5	0.0
Nondurables	1.5	1.5	2.4	2.2	1.9	1.5	1.6	1.0	5.4	-2.3	2.0	1.3	0.7
Services	1.4	3.9	2.4	2.2	1.9	1.5	1.6	1.0	3.0	2.5	2.3	1.3	0.7
Residential Investment	8.5	8.6	5.3	5.3	3.0	1.8	1.1	-0.2	13.2	1.9	5.9	1.1	2.6
Nonresidential Investment	2.4	10.3	6.0	3.7	5.4	4.0	1.3	-0.6	19.5	9.7	6.1	1.8	0.3
Structures	1.2	6.4	1.0	0.1	0.4	2.0	1.8	1.6	14.7	11.4	2.0	1.3	0.9
Equipment	3.0	12.4	8.7	5.6	8.5	1.9	1.0	1.6	22.2	8.7	8.3	2.0	0.0
Exports	5.1	8.0	5.6	5.1	4.9	4.9	4.6	4.4	6.2	2.9	3.3	4.6	3.9
Imports	12.8	13.0	9.7	6.9	1.5	0.7	0.2	2.3	22.8	2.1	9.0	-0.4	-2.1
Government Purchases	18.2	7.0	6.1	5.1	-0.7	0.6	0.2	0.2	4.3	5.9	1.0	-0.2	1.5
Contribution to GNP Growth													
Consumption	3.0	0.1	1.8	1.4	1.0	0.9	1.1	0.5	2.2	1.9	1.3	0.5	0.4
Residential Investment	0.4	0.4	0.3	0.3	0.1	0.1	0.1	0.0	0.2	0.3	0.2	0.0	0.2
Nonresidential Investment	0.3	1.3	0.8	0.5	0.7	0.5	0.2	0.1	1.9	0.8	0.6	0.0	0.1
Structures	0.1	0.3	0.0	0.0	0.0	0.1	0.1	0.1	0.6	0.4	0.0	0.1	0.0
Equipment	0.3	1.0	0.7	0.5	0.7	0.4	0.1	0.2	1.3	0.4	0.6	0.1	0.1
Inventory Change ($ billions)	1.9	0.2	1.8	1.4	0.5	0.0	0.2	-0.2	0.4	1.0	0.7	-0.2	-0.1
Net Exports	2.1	0.9	0.7	0.4	0.3	0.4	0.5	0.8	1.5	0.8	0.1	0.8	0.6
Government Purchases	3.4	1.4	1.3	1.0	0.1	0.1	0.0	0.0	1.5	1.4	0.6	0.0	0.5
Mfg. Capacity Utilization Rate	80.3	79.9	79.9	79.6	79.0	78.8	78.4	77.9	80.8	80.3	79.3	77.7	76.6
Personal Income Per Household	40,039	40,658	41,163	41,581	41,971	42,385	42,950	43,337	38,527	39,159	41,159	43,180	45,526
% Change	2.3	7.3	6.0	5.1	4.8	5.0	6.4	4.6	9.7	5.9	5.3	5.1	5.7
Personal Taxes Per Household	6,049	6,179	6,183	6,270	6,353	6,441	6,461	6,544	6,710	5,862	6,219	6,534	6,945
% Change	3.1	2.1	0.1	1.4	1.3	1.4	0.3	1.3	2.5	12.6	6.1	5.1	6.3
% of Personal Income	15.1	15.2	15.0	15.1	15.1	15.2	15.0	15.1	17.4	15.0	15.1	15.1	15.3
Disposable Personal Income Per Household	33,990	34,480	34,980	35,312	35,618	35,944	36,488	36,793	31,817	33,297	34,941	36,646	38,581
% Change	2.5	6.9	6.9	4.8	4.5	4.7	7.2	4.3	10.1	4.9	5.2	5.1	5.5
Employment (millions)	115.5	116.2	116.6	117.0	117.4	117.7	118.1	118.5	113.5	115.5	117.2	118.6	119.8
(civilian household basis)													
% Change	1.1	2.4	1.4	1.4	1.4	1.2	1.3	1.2	1.8	1.7	1.5	1.2	1.0
Unemployment Rate (%) (civilian)	7.2	7.0	7.0	7.0	7.1	7.1	7.1	7.3	7.5	7.2	7	7.3	7.8
Consumer Prices (CPI)	2.3	4.2	2.9	3.2	3.1	3.6	3.9	3.9	4.3	3.5	3.3	3.7	4.6
GNP Deflator	2.9	3.3	3.7	2.8	2.5	2.5	3.0	3.1	4.1	3.3	3.1	2.9	3.9
Personal Cons. Inflation	2.2	4.4	2.9	3.3	3.2	3.6	3.9	4.0	4.1	3.2	3.3	3.8	4.6
Residential Construction Inflation	1.1	3.0	2.3	2.2	2.3	2.7	3.3	3.3	4.2	1.7	2.2	3.0	4.1
Nonresidential Construction Inflation	1.2	0.4	2.3	0.8	1.1	0.9	1.7	1.9	0.5	1.4	1.2	1.5	3.0
Producer Price Inflation	0.7	4.2	2.4	2.9	3.3	4.2	4.5	4.6	2.1	0.9	2.6	4.2	5.0
Before Tax Corporate Profit	228.6	243.0	232.6	230.2	220.6	218.8	203.7	194.7	237.6	227.6	225.5	192.3	157.1
Corporate Tax Liability	87.5	92.9	87.6	86.4	81.5	80.5	73.4	69.3	93.6	86.6	84.0	68.2	51.5
After Tax Profits	141.1	150.1	145.0	143.8	139.1	138.3	130.3	125.4	144.0	141.0	141.5	124.1	105.6
Inventory Valuation Adjustment	4.7	9.6	5.3	-2.7	11.5	18.1	20.2	20.9	-5.4	0.4	11.1	21.2	26.3
Capital Consumption Adjustment	75.9	83.2	88.4	94.4	100.2	106.0	111.2	116.2	41.0	71.8	97.2	118.5	127.5
Federal Tax Receipts (NIPA)	790.7	869.9	817.0	825.4	830.3	838.9	842.8	848.3	725.1	786.3	827.9	851.5	899.9
% of GNP	19.7	19.9	19.7	19.7	19.6	19.6	19.5	19.4	19.2	19.7	19.7	19.4	19.5
Federal Expenditures (NIPA)	992.0	1023.4	1019.9	1011.2	1012.6	1017.7	1033.6	1041.0	898.0	983.0	1015.4	1045.0	1111.7
% of GNP	24.7	25.1	24.6	24.1	23.9	23.8	23.9	23.8	23.8	24.6	24.1	23.8	24.1
Deficit (NIPA)	201.3	213.5	202.9	185.8	182.3	178.8	190.8	192.7	172.9	196.6	187.5	193.5	211.7
% of GNP	5.00	5.20	4.90	4.40	4.30	4.20	4.40	4.40	4.60	4.90	4.50	4.40	4.60

Source: Forecast produced using Lawrence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns.

TABLE 2

February 1986

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1985.3	1985.4	1986.1	1986.2	1986.3	1986.4	1987.1	1987.2	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single Family Home Sales (1000's)	4,361	4,563	4,615	4,676	4,589	4,502	4,465	4,411	3,936	4,268	4,621	4,514	4,676
(single family resales and completions)													
Percent Change -- Year Ago	17.2	14.5	13.7	14.3	5.2	1.3	3.3	6.0	5.0	8.4	8.3	2.3	3.5
Existing Single Family Home Sales (1000's)	3,360	3,539	3,550	3,600	3,500	3,400	3,350	3,300	2,866	3,227	3,538	3,400	3,600
Percent Change -- Year Ago	21.6	19.0	19.5	18.1	4.2	3.7	5.6	8.3	5.5	12.6	9.6	3.9	5.9
Dollar Volume (billions)	310.5	298.6	390.4	392.4	379.4	377.4	365.0	353.1	247.1	358.8	389.1	363.8	396.2
Existing Home Prices -- Median ($1000's)	76.5	74.7	76.6	78.3	79.6	77.7	79.9	81.7	72.3	75.1	78.5	81.5	85.5
Percent Change -- Year Ago	4.5	3.9	3.8	4.1	4.1	4.0	4.2	4.3	3.5	3.8	4.6	3.7	4.9
Monthly Mortgage Payment(P&I 80% 30yr)	636	600	556	552	557	532	529	524	680	636	556	516	517
Percent of Median Family Income	28	27	24	23	23	22	21	21	32	29	23	21	20
Housing Starts	1,673	1,726	1,780	1,784	1,781	1,773	1,774	1,757	1,766	1,741	1,779	1,754	1,647
% Change	-20.5	13.3	13.1	0.9	-0.8	-1.7	0.3	-3.8	3.8	-1.4	2.2	-1.4	-6.1
Single Family Units	1,032	1,065	1,098	1,109	1,123	1,136	1,140	1,136	1,103	1,073	1,117	1,148	1,103
Percent Change	15.1	13.3	13.0	4.2	5.0	4.8	4.7	1.3	3.5	-2.7	4.0	2.8	-3.9
Multi Family Units	641	661	682	675	658	637	625	612	664	668	663	606	544
2-4 Family Units	89	83	85	84	82	80	78	76	122	95	83	76	68
% Change	48.5	24.4	13.3	4.3	9.9	-12.2	-7.2	-8.1	7.0	-22.2	-12.4	-8.6	-10.2
5+ Family Units	552	579	597	591	575	557	547	535	542	574	580	530	476
% Change	24.2	20.5	13.3	4.3	9.9	12.2	7.2	8.1	3.6	5.8	1.1	8.6	10.2
Mobile Homes Shipped	285	293	298	299	301	303	305	305	295	284	300	305	300
New Single Family Home Sales (1000's)	706	718	725	732	704	680	683	684	637	688	716	715	761
Percent Change -- Year Ago	15.0	10.5	8.4	11.4	-0.3	-5.3	-5.8	-6.6	1.3	7.9	4.2	-0.2	6.4
New Home Prices -- Median ($1000's)	83.4	85.5	87.1	88.7	90.1	91.6	93.1	94.7	80.0	83.9	89.4	95.4	102.0
Percent Change -- Year Ago	2.5	6.4	5.1	5.6	8.0	7.2	6.9	6.8	6.0	4.9	6.5	6.7	7.0
New Home Prices -- Mean ($1000's, Quality A	95.4	96.4	95.9	95.7	96.7	98.7	98.4	98.5	93.7	95.5	96.3	98.7	103.8
Percent Change -- Year Ago	0.3	1.3	0.7	0.7	1.4	2.4	2.6	2.9	4.5	1.9	0.8	3.5	4.1
NAR Affordability Index	95.5	99.8	104.3	106.4	108.2	114.6	116.7	118.8	86.2	93.8	106.8	121.2	126.7
Mortgage Debt Outstanding ($ billions)	2,258	2,366	2,375	2,391	2,456	2,524	2,590	2,657	1,948	2,210	2,470	2,763	2,909
Housing Inventory (millions)	96.1	96.6	96.9	97.3	97.7	98.1	98.5	98.9	94.4	95.9	97.5	99.2	99.9
Rental Vacancy Rate(%)	6.8	6.3	6.3	6.3	6.3	6.3	6.2	6.1	5.9	6.4	6.3	6.2	6.0
Office Vacancy Rate (%)<1>	15.3	15.0	14.5	14.3	14.1	14.0	14.0	13.9	13.9	15.5	14.2	13.6	12.5
Industrial Vacancy Rate (%) <1>	4.5	4.5	4.3	4.2	4.0	3.9	3.6	3.4	4.7	4.5	4.1	3.5	3.0
New Commercial Building Constr (% Ch Value)	0.1	12.1	8.8	8.2	7.7	6.6	7.9	17.5	33.7	25.6	6.8	6.6	7.7
New Industrial Building Constr (% Ch Value)	20.3	25.6	4.2	3.5	6.8	1.4	7.3	3.9	5.9	15.5	5.7	4.7	11.9
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.0	9.1	9.8	7.3	6.5	6.9	6.2	5.5	6.9	9.0	9.3	6.2	4.9
Velocity of M1 (% change)	8.8	2.9	3.2	2.2	2.4	-2.1	-1.4	1.3	3.8	-2.9	3.7	1.7	0.2
Monetary Base (% change)	8.8	7.2	6.5	6.0	5.3	4.9	4.7	5.3	8.1	7.2	6.8	5.0	4.3
Value of the U.S. Dollar (Trade-Weighted)	1.392	1.282	1.240	1.227	1.215	1.203	1.194	1.184	1.383	1.432	1.221	1.180	1.152
Percent Change	23.9	28.1	12.5	4.0	4.0	4.0	3.8	3.0	10.4	3.5	14.7	3.4	2.4
Flow of Funds (NIA Basis)													
(Billions of dollars,saar)													
Sources:(total gross savings)	681.9	704.7	724.1	726.7	731.2	734.3	748.4	753.7	693.3	696.8	729.1	758.5	793.8
Private Saving													
Personal Saving	102.6	118.1	127.4	124.5	124.3	123.3	135.5	134.6	172.6	129.7	124.9	135.2	152.5
Savings Rate	3.7	4.1	4.4	4.2	4.2	4.1	4.4	4.4	6.5	4.6	4.2	4.4	4.7
Gross Business Savings	579.3	586.6	596.7	602.2	606.9	611	612.9	619.1	520.7	567.1	604.2	623.3	641.3
Federal Deficit	201.3	213.5	202.9	185.8	182.3	178.8	190.8	192.7	172.9	196.6	187.5	193.5	211.7
State & Local	56.9	56.3	55.3	52.3	47.1	44.8	42.8	40.1	64.4	58.4	49.9	38.7	35.7
Net Foreign Investment	126.2	135.5	136.0	136.9	143.0	145.2	151.0	154.9	91.0	111.1	140.3	154.3	155.5
Uses (total gross investment)	666.1	685.2	713.7	735.8	741.8	750.8	754.9	756.5	674.0	670.4	735.5	758.3	773.4
Nonresidential Investment	473.7	485.4	492.5	497.0	503.6	508.5	510.1	509.4	430.3	471.8	500.4	509.4	510.8
Structures	165.8	168.4	168.8	168.9	168.7	169.5	170.3	171.0	148.7	165.7	169.0	171.2	172.7
Equipment	307.9	317.0	323.7	328.1	334.9	339.0	339.9	338.5	281.5	306.1	331.4	338.2	338.1
Residential Investment	173.1	176.7	179.0	181.3	182.7	185.5	183.9	183.8	168.4	171.5	181.6	183.5	178.8
Inventory Investment	-1.8	0.1	16.3	28.7	23.9	24.3	22.1	20.4	62.7	7.5	23.3	20.0	14.5
Selected Interest Rates (%)													
Mortgage Rates													
30 year Fixed Rate Mortgage Rate<2>	12.1	11.3	10.5	10.2	10.1	9.9	9.5	9.2	13.8	12.2	10.2	9.1	8.7
Real Mortgage Rate	9.2	8.0	6.8	7.4	7.6	7.4	6.5	6.1	9.7	8.9	7.1	6.2	4.8
1 year ARM (without buydown)	9.7	9.5	9.7	9.8	9.6	9.3	9.3	9.2	12.6	10.1	9.6	9.1	9.2
Real Mortgage Rate	6.8	6.2	6.0	7.0	7.1	6.8	6.3	6.1	8.5	6.8	6.5	6.2	5.3
Corporate AAA Bond Rate	11.0	10.6	9.9	9.6	9.5	9.3	9.0	8.7	12.7	11.4	9.6	8.6	8.2
Government Bond Rate	10.7	10.2	9.6	9.3	9.2	9.0	8.7	8.4	12.5	11.0	9.3	8.3	7.8
Real Government Bond Rate	7.8	6.9	5.9	6.5	6.7	6.5	5.7	5.3	8.4	7.7	6.2	5.4	3.9
Federal Funds Rate	7.9	8.1	7.8	7.5	7.2	7.0	6.9	6.6	10.2	8.1	7.4	6.5	7.2
3 month T Bill Rate	7.1	7.2	7.0	6.8	6.6	6.4	6.4	6.2	9.5	7.5	6.7	6.1	6.6
Real 3 Month T Bill Rate	4.2	3.9	3.3	4.0	4.1	3.9	3.4	3.1	5.4	4.2	3.6	3.2	2.7
1 Year Treasury Bill Rate	8.0	7.8	8.0	8.1	7.9	7.6	7.6	7.5	10.9	8.4	7.9	7.4	7.5
Real 1 Year T-Bill Rate	5.1	4.5	4.3	5.3	5.4	5.1	4.6	4.4	6.8	5.1	4.8	4.5	3.6
Commercial Paper Rate	7.7	7.8	7.7	7.5	7.3	7.1	7.0	6.7	10.1	8.0	7.4	6.5	7.3
Prime Rate	9.5	9.5	9.1	8.8	8.5	8.2	8.1	7.8	12.0	9.9	8.7	7.7	8.1
Discount Rate	7.5	7.5	7.3	7.1	7.0	6.8	6.7	6.5	8.8	7.7	7.1	6.5	6.6

<1> Historical Data courtesy of Coldwell Banker
<2> FHA secondary mortgage market rate.

Source: Forecast produced using Lawrence H. Meyer & Associates' model of the U.S. economy
Assumptions and simulations by Dr. Richard Peach, Janemarie Mulvey, and Sean Burns